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Cashflow Management Practices and Financial Performance of Small and Medium Business Enterprises in Kenya

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Abstract

This comprehensive review examines cash management and its impact on the financial performance of Small and Medium Enterprises (SMEs). The review covers theories, practices, and empirical evidence, providing insights into financial management strategies. Theoretical perspectives include the Dynamic Trade-Off Theory and the Free Cash Flow Theory, which shed light on the implications for SMEs' financial management strategies. Empirical evidence underscores the importance of cash accountability, internal controls, cash policy, cash budgeting, and financial performance metrics like profitability, liquidity, and solvency. Effective cash management is crucial for SMEs as it enables growth, optimizes investments, enhances profitability, and ensures financial stability. This synthesis offers valuable insights for policymakers, practitioners, and academics seeking to understand and enhance SMEs' financial performance through sound cash management practices.

Keywords: Cashflow Management Practices, Success, Financial Performance, SMEs, Cash policy, Cash budgets, Cash accountability

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1. Introduction

Cash flow management involves overseeing the movement of money in and out of a business, which impacts its ability to acquire assets, compensate employees, service debt, and regulate operations to achieve organizational objectives. Treasury management, synonymous with cash management, involves monitoring and managing cash flows across a company's operations, financing, and investments. Effective cash management is crucial for managing working capital, ensuring financial obligations are met, and

enhancing stability and financial resilience, as highlighted by Williams (2013). CIMA (2002) notes the indispensability of cash management for business operations, as emphasized by Abioro (2013).

Cash is a vital asset for individuals and businesses, essential for meeting financial obligations. Prudent management is necessary for organizational stability, future planning, and fulfilling commitments. The amount of cash held by an entity is influenced by factors such as growth opportunities, asset sales, and dividends to shareholders.

Keynes's General Theory (1990) outlines various motives for holding cash, including precautionary, transactional, and speculative motives, underscoring its role in ensuring financial stability and profitability. Effective cash management involves making timely expenditure decisions, proactive banking, revenue collection, and accurate cash flow projections to optimize fund allocation and minimize borrowing, as highlighted by Barrett (1999).

The primary goal of most businesses is effective cash flow management to sustain operations. Small and medium-sized enterprises (SMEs) in developing nations play a crucial role in poverty reduction and economic development. However, they often encounter challenges due to stakeholders' limited understanding of cash flow management, as highlighted by Kongolo (2010). Afrifa and Tingbani (2018) emphasizes the critical impact of cash flow management on SMEs' financial performance, which is essential for their growth and survival. Given the discussions on the role of small and medium-sized enterprises (SMEs) in economic growth, employment, and poverty alleviation, effective cash flow management remains imperative for their progress and prosperity, as emphasized by Afrifa and Tingbani (2018).

1.2 Cashflow Management

Cash flow management involves the systematic handling, regulation, and investment of an organization's liquid assets to optimize their utilization. It is considered crucial for the sustainability and operational vitality of a business. Barrett (1999) defines cash management as a strategic process aimed at maximizing the value of cash flow, while Storkey (2003) emphasizes the importance of having the right amount of cash available at the appropriate time and place to meet the entity's obligations cost-effectively. Zimmerer, Scarborough, and Wilson (2008) describe cash management as encompassing tasks such as fund collection, forecasting, allocation, investment, and strategic planning of financial resources necessary for the organization's efficient functioning.

Effective cash management is essential for the financial health of any entity, as mismanagement can lead to the downfall of otherwise profitable businesses. Akinyomi (2014) emphasizes the critical role of cash flow control and planning in determining an entity's success. Despite its importance, cash is often considered the least productive asset in a business's portfolio. The amount of cash held by a business depends on factors such as its size and operational needs. The entity needs to maintain a sufficient cash reserve to achieve financial goals and prevent bankruptcy. Hamza et al. (2015) highlight that sound cash management strategies significantly impact financial performance, emphasizing the need for financial decision-makers to integrate efficient cash management practices to enhance business sustainability in a dynamic and unpredictable environment.

The primary goal of cash management, as articulated by

Soaga (2012), is to determine the optimal cash level to achieve the highest organizational performance standards. Effective cash management principles involve making timely expenditure decisions, promptly collecting and banking revenue, and accurately forecasting cash flow dynamics. These practices, as suggested by Barrett (1999), help reduce costs associated with unnecessary borrowing and enable the prudent investment of surplus funds for optimal returns. Increased cash inflows are likely to reduce costs associated with cash collection and management, resulting in higher profitability. However, shortening the credit timeframe may negatively impact sales, leading to reduced profits and revenue.

1.3 Financial Performance

Financial performance, as articulated by Harash, Alsaad and Ahmed (2013), serves as a reflection of an entity's financial position or outcomes resulting from the strategic decisions made by the organization's management. It assesses how effectively an organization leverages its assets to generate revenue. Key ratios employed in the evaluation of financial performance encompass profitability ratios, gearing ratios, and liquidity ratios. Profitability ratios measure the efficiency of resource utilization, gearing ratios quantify the extent of financial leverage, while liquidity ratios gauge the entity's ability to meet its short-term obligations as they arise. A crucial determinant of an entity's financial health is its financial statements, which comprise reports on the financial outcomes of the organization over a specific period. The four main financial statements include the statement of comprehensive income, financial position statement, cash flows statement, and statement of changes in equity. Diana and Maria (2020) underlines profitability as a significant indicator of financial performance, citing return on equity (ROE) and return on assets (ROA) as key metrics for assessing profitability. Additionally, net profit is highlighted as a pivotal measure, representing the ratio of an entity's net profit to its sales.

Gao (2010) and Miller, Boehije and Dobbins (2013) emphasize that an organization's financial performance reflects its operational efficiency, sales and profit enhancement, and ability to thrive in a competitive business environment. Among the financial metrics utilized for assessing a company's financial performance is the assessment of free cash flow. Frank and James (2014) elaborate that free cash flow demonstrates a company's available cash after accounting for both capital and operational expenses. In the context of this study, net profit margin was employed as a metric for evaluating financial performance, calculated by dividing operating profit by sales, providing a crucial insight into the organization's operational efficiency and profitability.

1.4 Cashflow Management and Financial Performance

Organizations of varying sizes employ a range of resources to sustain their activities, with cash being a crucial asset that can significantly impact a company's performance and overall success. Oluoch (2016) emphasizes the significance of efficient cash management in enabling businesses to effectively utilize their limited cash reserves. This ensures the availability of sufficient funds to support operational activities, investments, and financial obligations, ultimately enhancing profitability. The relationship between cash management and financial performance has been extensively studied in relation to factors such as bankruptcy, liquidity, working capital, and overall financial health. This is a key area of interest for managers and stakeholders. This study focuses specifically on small and medium-sized enterprises (SMEs) in Nairobi County, Kenya. It is based on the premise that effective cash management is essential for their sustainable growth.

Miller, Boehije, and Dobbins (2013) emphasize the importance of liquidity as a crucial factor for organizations to fulfill short-term obligations while sustaining profitability. Efficient cash management not only enhances an organization's sustainability but also attracts potential investors seeking to inject capital for expansion. Investors often evaluate a company's cash flow management strategy as a key criterion for investment decisions, underscoring the importance of effective cash management in attracting external funding.

Cash management is considered a cornerstone of business operations, playing a vital role in strengthening the financial health of an organization. The Miller-Orr model, introduced by Miller and Orr in 1961, emphasizes the significance of maintaining optimal cash balances and adjusting investment decisions in response to cash flow constraints, prioritizing essential investment opportunities. The cash conversion theory, as outlined by Gitman (1974), suggests that a shorter cash conversion cycle leads to improved financial performance, emphasizing the need to minimize this cycle to ensure a steady cash inflow. Access to capital enables increased production and sales, ultimately driving enhanced profitability.

1.5 Small and Medium Enterprises

Small and medium enterprises (SMEs) lack a universally agreed-upon definition, as the criteria for categorizing them often vary based on geographical regions. According to the Henschel and Heinze (2018), small and medium-sized enterprises (SMEs) are considered independent entities without subsidiaries that employ fewer than a specific number of workers, with the upper limit varying across regions. For example, in Europe, the threshold is set at 250 workers, while in some African countries like Kenya, it is defined as entities with up to 200 workers. Conversely, the United States classifies SMEs as entities with a maximum of 500 employees. In Kenya, small and medium enterprises

(SMEs) are classified under Micro, Small, and Medium Enterprises (MSMEs), including businesses with 1 to 99 employees. This classification encompasses the majority of businesses in the country.

The significance of small and medium-sized enterprises (SMEs) in the global economy is substantial, particularly in emerging countries, where they represent a significant portion of businesses and make a substantial contribution to economic growth and employment generation. According to the World Bank, small and medium-sized enterprises (SMEs) represent around 90% of all businesses worldwide and contribute over 50% of total global employment. In emerging economies, formal SMEs can contribute up to 40% of the GDP, playing a crucial role in fostering socio-economic development and accelerating industrialization, as emphasized by Oteyo (2018) and Prillwitz and Barr (2011).

In the Kenyan context, small and medium-sized enterprises (SMEs) play a crucial role in the nation's economic development and job creation. According to the Central Bank of Kenya (CBK), small and medium-sized enterprises (SMEs) constitute 98% of the country's entire business landscape, with a significant portion operating within the informal sector. The Kenya National Bureau of Statistics (KNBS) 2019 Economic Survey indicates significant growth in the Kenyan economy, with over 800,000 new jobs created in 2018. The majority of these jobs were generated by Small and Medium Enterprises (SMEs) within the informal sector, contributing to 83.6% of overall employment. This growth was primarily driven by increased small and medium-sized enterprises (SMEs) activities in various sectors such as agriculture, manufacturing, transport, and services.

2. Literature Review

2.1 Introduction

This section offers an examination of the different theories that support the research, along with an empirical review that explores the cash management practices and financial performance of SMEs.

2.2 Theoretical Framework

The text discusses two theories, namely the Dynamic Trade-Off Theory and the Free Cash Flow Theory, in relation to the impact of cash flow management on financial management.

Dynamic Trade-Off Theory

The Dynamic Trade-Off Theory, introduced by Fischer, Heinkel, and Zechner in 1989, suggests that firms adjust their leverage over time due to transaction costs, aiming to maintain their capital structure close to the desired level. In contrast, the classic Trade-Off Theory by Modigliani and Miller in 1963 advocates for firms to maximize leverage to increase value by using interest expenses to reduce taxes. Kraus and Litzenberger (1973) propose that the optimal debt-

to-equity ratio balances the benefits and costs of leverage, taking into account factors such as tax advantages and potential distress costs. Empirical studies support the idea that the optimal debt-equity ratio is determined through a thorough assessment of the costs and benefits associated with leverage, which are influenced by firm characteristics such as profitability, size, growth prospects, and asset tangibility. The Trade-Off Theory explains how market imperfections affect the relationship between leverage levels and corporate value, helping firms align with their target leverage ratios.

Moreover, the Dynamic Trade-Off Theory accounts for the dynamic nature of capital structure. Fischer, Heinkel, and Zechner suggest a model in which firms allow their debt levels to fluctuate within an optimal range. The speed at which firms adjust their capital structure to reach the target leverage is termed as the capital structure adjustment speed. This concept acknowledges the presence of adjustment costs that may cause firms to deviate from their target leverage for extended periods. Recent developments in the theory, such as dynamic panel adjustment models and the consideration of leverage deviation, offer a more nuanced understanding of how firms manage their capital structure over time. These advancements take into account adjustment costs and market imperfections in firms' decision-making processes.

Free Cash flow Theory (FCP)

Jensen introduced the Free Cash Flow (FCF) theory in 1986, emphasizing that companies with substantial FCF often engage in suboptimal projects, exacerbating the agency conflict between management and shareholders and reducing firm value. Jensen argues that when Free Cash Flow (FCF) exceeds the amount needed for positive Net Present Value (NPV) projects, managers frequently misuse it on investments that yield returns below the cost of capital. To address this issue, the Free Cash Flow (FCF) theory suggests using debt as a tool to reduce the agency costs linked to FCF. It is suggested that debt is a more effective tool than dividends in restricting managers' access to resources. Managers are obligated by debt commitments, unlike dividends, which allow them to influence the firm's future Free Cash Flow (FCF) and potentially reduce dividends to the detriment of shareholders. Several empirical studies consistently support the Free Cash Flow (FCF) theory.

Vogt's (1994) research provides evidence for the Free Cash Flow (FCF) theory in large firms with low dividend payouts and investments in tangible assets. Richardson's (2006) study establishes a positive relationship between overinvestment and free cash flow (FCF) for companies with excessive cash flows. Park and Jang's (2013) research demonstrate how Free Cash Flow (FCF) can negatively impact the performance of firms in the restaurant industry due to overinvestment. Similarly, Kadioglu and Yilmaz's (2017) analysis reveals a negative relationship between leverage and FCF, as well as dividends and FCF, providing empirical evidence for the FCF hypothesis in the context of Turkish companies. Yero et al. (2021) study in Nigeria reveals a direct and statistically significant influence of Free Cash Flow (FCF) on agency costs, as well as a notably negative impact of leverage among listed food and beverage firms.

Lai et al.'s (2020) study in Malaysia reveals an inverse relationship between FCF and financial performance and firm value. Furthermore, Dogru et al. (2020) and Kwon et al. (2021) bolster the FCF theory by emphasizing its influence

on returns and overinvestment in franchising firms, as well as the effectiveness of shareholder intervention in reducing overinvestment by overconfident CEOs. The Free Cash Flow (FCF) theory is of paramount significance in this study as it elucidates the connection between cash flows, investment choices, and firm value. It emphasizes how excessive FCF can result in value erosion when managers allocate it to suboptimal projects at the expense of shareholders.

2.3 Empirical Review

Cash accountability

Cash accountability involves the systematic and responsible management of cash resources within an organization to ensure transparency, accuracy, and compliance with financial protocols. According to the Chartered Institute of Public Finance and Accountancy (CIPFA), cash accountability encompasses processes that oversee the proper handling of cash transactions, maintenance of records, and establishment of internal controls to prevent mishandling or misappropriation of funds. It requires maintaining a clear cash flow trail from receipt to expenditure and implementing stringent monitoring mechanisms to ensure financial integrity and accountability. Ogutu (2022) emphasize the importance of establishing clear protocols and procedures to track cash inflow and outflow, thereby reducing the risk of financial mismanagement, fraud, or embezzlement. The International Federation of Accountants (IFAC) describes cash accountability as the ethical and professional responsibility of financial professionals to uphold transparency and honesty in cash transactions within an organization. Effective cash management practices, including accurate financial reporting, regular audits, and strong internal controls, are essential to maintain financial accountability and integrity.

Internal control measures significantly impact the growth and investment capabilities of Small and Medium Enterprises (SMEs), as noted by Nyakundi et al. (2014). By ensuring efficient allocation of funds and minimizing misallocation risks, effective cash accountability supported by stringent internal controls enables SMEs to pursue strategic investments and expansion opportunities. Atieno and Kiganda (2020) highlight that implementing internal control measures in cash accountability creates an environment conducive to sustainable growth and investment, allowing SMEs to allocate resources wisely and make informed decisions on capital expenditure for long-term business development. Uwineza and Maringa (2022) point out a positive correlation between effective internal control measures in cash accountability and SME profitability. Implementing rigorous control procedures enhances cash inflow and outflow management, reducing financial leakages and improving overall business profitability. This optimization of financial resources enables SMEs to achieve greater profitability over time. Additionally, Baya (2023) stress that sound internal control measures contribute to enhanced profitability in SMEs by promoting transparency and accountability in cash management, thereby reducing financial irregularities and improving financial performance.

According to the research conducted by Mutiso (2019), it has been established that the effective implementation of internal control measures in managing cash accountability has a positive impact on the liquidity and solvency positions

of Small and Medium Enterprises (SMEs). This influence is manifested through the assurance provided by proper cash monitoring and management, as internal controls are instrumental in upholding adequate levels of liquidity. This, in turn, enables SMEs to meet their short-term financial obligations and operational expenses in a timely manner, thereby contributing to the overall financial health of the businesses. Nyakarimi et al (2020) further support this notion by asserting that the establishment of robust internal control measures plays a pivotal role in enhancing the analysis of liquidity and solvency within SMEs. Through the implementation of effective protocols for cash accountability, SMEs are able to sustain sufficient cash reserves, ultimately leading to an enhanced liquidity position. This improvement in liquidity not only fortifies the ability of SMEs to meet their financial obligations promptly but also strengthens their capacity to repay debts, consequently elevating their overall solvency status.

Moreover, the research conducted by Safari and Mwanyefa (2024) underscores the significance of maintaining robust financial transparency and reporting standards in positively influencing the growth and investment potential of businesses. This influence is evident in the establishment of trust with stakeholders and the attraction of potential investors through the upkeep of transparent financial records and adherence to standardized reporting practices. As a result, businesses are able to broaden their access to capital and investment opportunities, thereby fostering growth and expansion within the business environment. Kamau and Mungai (2020) emphasize the impact of stringent financial transparency and reporting standards on the profitability of enterprises. By adhering to such standards, businesses enhance the credibility and reliability of their financial information, subsequently bolstering investor confidence. This heightened trust among stakeholders facilitates the negotiation of favorable lending terms, increased investor participation, and ultimately contributes to improved profitability and sustainable financial performance.

A study conducted by Salehi et al (2023) further supports the notion that the implementation of effective financial transparency and reporting standards significantly influences the analysis of liquidity and solvency within businesses. The adoption of transparent financial reporting practices ensures the provision of accurate and reliable financial data, which in turn enables enterprises to conduct informed assessments of their liquidity and solvency positions. This, in effect, allows businesses to make prudent financial decisions that are conducive to their overall financial stability and long-term solvency. Additionally, the research by Fuadah and Setiyawati (2020) sheds light on the critical role played by financial transparency and reporting standards in enhancing the liquidity and solvency positions of enterprises. Through the maintenance of clear and comprehensive financial reporting, businesses are able to enhance their credibility, consequently expanding their access to financial resources and improving their liquidity and solvency ratios. These improvements are essential for the sustenance of financial stability and the assurance of long-term viability within the business sector.

Furthermore, the study conducted by Kuria et al (2022) demonstrates the significant contribution of effective cash forecasting and planning towards fostering growth and investments for businesses. Accurate cash forecasting enables

enterprises to strategically plan their investments, ensuring the availability of sufficient funds for expansion and the pursuit of new ventures. This proactive approach to cash management facilitates confident decision-making, thereby encouraging investments that can catalyze business growth and expand market share. The findings presented by Mutiso and Muigai (2018) highlight the positive impact of meticulous cash forecasting and planning on the profitability of businesses. By systematically assessing cash flows, businesses can identify potential surpluses or shortages, allowing them to optimize their investment and operational strategies. This streamlined approach to cash management serves to mitigate the risks associated with financial shortfalls, consequently enhancing overall profitability and financial performance.

The investigation carried out by Mukoya and Sasaka (2021) underscores the crucial importance of cash forecasting and planning in impacting the analysis of liquidity and solvency within organizations. By making precise projections of forthcoming cash flows and preparing for potential financial duties, firms can ensure a steady and enduring liquidity stance. This proactive strategy towards cash management empowers enterprises to alleviate possible solvency hazards and uphold a robust financial status, thereby contributing to enhanced liquidity and improved solvency ratios. Moreover, a study by Abioro (2013) accentuates the significance of cash forecasting and planning in upholding optimal levels of liquidity and solvency. Through thorough cash strategizing, organizations can efficiently handle their financial responsibilities, guaranteeing the presence of sufficient funds to fulfill short-term commitments and sustain long-term solvency. This method of cash responsibility nurtures a secure financial atmosphere, consequently safeguarding the liquidity and solvency positions of enterprises.

Cash policy

Cash policy can be defined as a comprehensive framework comprising guidelines, rules, and procedures utilized by organizations to effectively manage and control their cash resources. It establishes a strategic framework for handling cash inflows and outflows, ensuring optimal fund utilization while mitigating risks. According to Hamza et al (2015), cash policy governs the acquisition, utilization, and monitoring of cash within an organization, incorporating strategic guidelines and operational protocols for efficient cash flow management aligned with financial objectives.

Kamau and Muigai (2020) stress that cash policy signifies the structured approach adopted by enterprises to regulate cash-related activities. It entails developing specific protocols and practices guiding cash handling, including collection, disbursement, and investment procedures, aiming to optimize financial performance. As per Afrifa and Tingbani (2018) definition, cash policy encompasses principles and protocols governing an entity's cash management strategy, establishing clear guidelines for cash handling, budgeting, and investment decisions to enhance cash accountability and resource allocation.

Mun et al (2020) argue that a well-defined cash policy, including clear guidelines on reserves and investment strategies, can support growth and investments. Sufficient cash reserves provide a safety net for seizing opportunities, making strategic investments, and business expansion.

Hamza (2015) contend that aligned cash reserves and investment policies with strategic objectives facilitate growth by providing funds for projects, acquisitions, and capital expenditure.

Safari and Mwaneyefa (2024) emphasize that a prudent cash policy, integrating reserves and investment strategies, can improve profitability by allocating excess cash to investments generating higher returns. Lai et al (2020) suggest that effective management of reserves and investments minimizes opportunity costs, actively utilizing cash for profit generation and increased profitability. They stress the crucial role of cash reserves in maintaining liquidity within a cash policy, ensuring prompt meeting of short-term obligations for strong liquidity. Bintara (2020) note the importance of investment policies balancing profitability and liquidity for strong solvency while meeting financial obligations.

Efficient cash disbursement and payment policies, as highlighted by Kanakriyah (2020), can facilitate growth and investments through streamlining cash outflows. Timely fund disbursement supports project operation, aiding business expansion and investment initiatives. He further underlines that a well-structured disbursement and payment policy ensures financial stability and accuracy, creating a conducive environment for business growth and strategic investments.

Lasmana et al (2022) posit that an effective cash disbursement and payment policy can have a positive impact on profitability. Through the implementation of streamlined payment procedures, organizations can enhance cash flow, reduce expenses related to delayed payments, and ultimately improve their financial performance. Puspitarini et al (2023) contend that proficient management of cash disbursement and payment strategies can lead to increased profitability by lowering transaction costs and enhancing cash flow management, thereby creating better investment prospects.

Kanakriyah (2020) stress the importance of a well-organized cash disbursement and payment policy in maintaining liquidity. Effective payment policies guarantee that enterprises maintain adequate liquidity to fulfill short-term commitments, consequently improving overall financial stability. Lasmana et al (2022) underscore the significance of judicious cash disbursement and payment policies in supporting liquidity and solvency analysis by mitigating default risks and ensuring the availability of funds to meet financial obligations, thereby reinforcing solvency positions.

The establishment of a clearly defined cash reserve policy can have a favorable influence on growth and investment opportunities. As recommended by Mikkelson (2003), maintaining sufficient cash reserves enables a company to capitalize on growth prospects, whether through strategic acquisitions, market expansions, or research and development projects. This financial cushion provides the flexibility required for investing in new ventures without relying on external funding. An effective investment strategy, as outlined by Kwon et al (2021), can facilitate the generation of returns on surplus cash, thus enhancing the capacity for investment. By adhering to a well-defined investment approach aligned with risk tolerance and financial goals, organizations can accumulate capital for future investments, fostering sustainable growth.

Cash reserves play a crucial role in positively impacting profitability by serving as a safeguard against unforeseen

expenses or economic downturns. According to Mun et al (2020), cash reserves act as a protective buffer that enables companies to navigate financial challenges without jeopardizing profitability. By avoiding the necessity for expensive external financing during challenging periods, profitability is safeguarded. Investment Policies: Effective investment policies can bolster profitability by generating returns on excess funds. Bintara (2020) suggest that a well-structured investment policy can maximize returns while managing risks effectively. Greater returns from investments can contribute to an overall increase in profitability. Mikkelson (2003) highlight the importance of maintaining adequate cash reserves for sustaining liquidity. A robust cash position empowers a company to meet short-term obligations, such as supplier payments or debt servicing, without resorting to external financing. This enhances liquidity, thereby fortifying solvency by ensuring the fulfillment of financial commitments. Arena and Julio (2015) posit that the appropriate investment policies can influence liquidity and solvency analysis by striking a balance between preserving liquidity and earning returns on idle cash. Through prudent investments, organizations can maintain sufficient liquidity for operational needs while optimizing returns to strengthen solvency.

In summary, cash reserves and investment policies, when well-structured and aligned with a business's financial goals, can have a substantial impact on its growth and investments, profitability, as well as liquidity and solvency analysis. These policies act as strategic tools to manage cash effectively and enhance overall financial performance.

Cash budget

A cash budget is a financial blueprint delineating projected cash inflows and outflows within a specified timeframe, typically monthly or quarterly, offering a comprehensive portrayal of anticipated cash receipts and disbursements for effective cash resource management. It plays a pivotal role in aiding businesses to strategize and oversee their cash flows, enabling them to evaluate liquidity positions, make well-informed decisions on investments, expenses, and financing endeavors. Through the prediction of forthcoming cash flows and scrutiny of anticipated cash needs, a cash budget empowers businesses to proactively administer their working capital, ensuring the availability of ample funds to fulfill financial obligations and pursue growth prospects.

A cash budget serves as "a detailed scheme displaying the acquisition and utilization of cash resources over a defined period, spotlighting anticipated cash inflows and outflows during the designated timeframe. It represents a concise financial scheme illustrating the projected cash inflows and outflows for a specific period (Mishra, 2018)." The fundamental objective of a cash budget is to strategize and regulate cash receipts and payments, thereby guaranteeing the accessibility of sufficient funds when necessitated." Cash budget is characterized as "a foresight of the company's projected cash inflows and outflows over a specified period, such as a month or quarter, facilitating in the organization and governance of the business's cash flows.

The cash budget plays an instrumental role in guiding management towards judicious decisions concerning investment, financing, and dividend strategies to ensure the timely availability of cash." Cash budget is defined as "a

financial scheme forecasting cash inflows and outflows over a specified period, typically on a monthly or quarterly basis, essential for steering a company's short-term liquidity and enabling management to make educated decisions regarding fund allocation. It aids in gauging the cash requirements of the company and helping ascertain the optimal cash position to meet operational and investment needs."

Research by [Maritan and Lee \(2017\)](#) underscores the substantial impact of budget allocation on the advancement and investment of businesses. Their findings suggest that an effective budget allocation approach correlates positively with heightened investment in productive assets, research and development, and market expansion, fostering business growth and enriching investment prospects.

[Maritan and Lee's](#) study concluded that proficient budget allocation positively impacts a company's profitability. Their analysis accentuated that firms efficiently distributing budgets across various divisions and projects witness enhanced cost control, resource management, and revenue generation, culminating in increased profitability through optimal utilization of available financial resources.

In a study conducted by [Uwonda et al \(2013\)](#), it was determined that the allocation of budgets and the efficiency of allocation have a significant impact on the analysis of liquidity and solvency in enterprises. The research conducted by them indicated that an effective allocation of cash budgets, along with efficient utilization of resources, results in enhanced liquidity positions, decreased debt burdens, and improved solvency ratios. This underscores the significance of prudent budget allocation practices in upholding healthy levels of liquidity and solvency for the sustainable operations of businesses.

In their study, Peterson and Sharma discovered that variance analysis plays a critical role in comprehending the patterns of growth and investment in businesses. Their research highlighted the importance of a thorough analysis of budget variances in pinpointing areas of underperformance or excessive spending, thus enabling businesses to make well-informed decisions to optimize their investment strategies and foster sustainable growth.

According to the findings of the research by [Ali-Momoh et al \(2022\)](#), variance analysis has a direct impact on the profitability of businesses. Their study underscored that a detailed analysis of budget variances allows companies to detect instances of cost overruns, revenue shortfalls, or inefficiencies in resource allocation, thereby empowering them to implement corrective actions and enhance profitability through improved cost control and revenue management.

In the research carried out by [Dandago and Adah \(2013\)](#), it was observed that variance analysis significantly influences the analysis of liquidity and solvency in enterprises. Their study emphasized that effective variance analysis assists businesses in monitoring fluctuations in cash flow, evaluating liquidity risks, and ensuring efficient allocation of resources, thus contributing to enhanced liquidity positions and improved solvency ratios. This highlights the crucial role of variance analysis in preserving stable financial health and solvency for the sustainable operations of businesses.

[Mun et al \(2020\)](#), in their study, emphasized the importance of cash reserves and contingency planning in facilitating the growth and investment of businesses. Their findings revealed that maintaining sufficient cash reserves

and well-structured contingency plans allows businesses to capitalize on growth opportunities, withstand financial uncertainties, and make strategic investments while safeguarding their financial stability. The research by [Tarus and Juma \(2017\)](#) indicated that cash reserves and contingency planning directly impact the profitability of businesses. Their study emphasized that strong cash reserves and carefully crafted contingency plans offer businesses a financial cushion during challenging periods, thereby reducing the effects of unexpected events on profitability and ensuring consistent financial performance in various market conditions.

In the study conducted by [Grizzle et al \(2015\)](#), it was found that cash reserves and contingency planning have a significant influence on the analysis of liquidity and solvency in enterprises. Their research highlighted that maintaining adequate cash reserves and implementing effective contingency plans enhances liquidity positions, diminishes financial risks, and fortifies solvency ratios, thereby contributing to the overall financial stability and long-term viability of businesses. This underscores the importance of cash reserves and contingency planning in guaranteeing sound liquidity and solvency analysis for businesses.

Financial performance

Financial performance, in terms of growth and investments, indicates how well SMEs can expand their operations, explore new market opportunities, and invest in innovative ventures. Effective cash flow management ensures that SMEs have enough funds for capital investments, research and development, and market expansion. It enables businesses to take advantage of growth opportunities, such as product diversification, geographical expansion, and technological advancements. This fosters long-term sustainability and competitiveness within local and regional markets. According to [Tarasi et al \(2013\)](#), effective cash flow management allows businesses to allocate resources efficiently and make strategic investments that contribute to sustainable growth. Additionally, [Kamau and Muigai \(2020\)](#) emphasize that prudent cash flow management is essential for SMEs to expand their market presence and explore new investment opportunities.

Financial performance related to profitability highlights the ability of SMEs to generate sustainable profits and maximize returns on investment. Effective cash flow management plays a pivotal role in optimizing revenue streams, controlling costs, and managing financial risks. By maintaining a healthy balance between cash inflows and outflows, SMEs can enhance profitability through improved operational efficiency, effective cost management, and prudent financial decision-making. This, in turn, contributes to the overall financial stability and resilience of SMEs in Kenya. [Bintara \(2020\)](#) argue that effective management of cash flow positively impacts the profitability of SMEs by enabling better control over expenses and maximizing revenue generation. Similarly, research by [Tarasi et al \(2013\)](#) highlights the significance of managing cash flows to ensure healthy profit margins and sustainable business growth for SMEs in developing economies.

Assessing financial performance concerning liquidity and solvency analysis involves evaluating the ability of SMEs to meet their short-term and long-term financial obligations. Cash flow management directly influences the liquidity position and solvency ratios of SMEs, ensuring that they have

enough liquid assets to cover their immediate financial requirements and honor their long-term debt obligations. By effectively managing cash flows, SMEs can enhance their liquidity positions, reduce financial risks, and improve their overall solvency. This instils confidence among stakeholders, investors, and creditors about the financial soundness and stability of the business. Almeida (2021) suggest that efficient cash flow management is instrumental in maintaining adequate liquidity levels, thereby reducing the risk of financial distress and enhancing the overall solvency position of SMEs. Additionally, Williams (2013) emphasize the importance of effective cash flow management in ensuring the timely settlement of financial obligations, thereby enhancing the liquidity and solvency profiles of SMEs.

2.4 Conceptual Framework

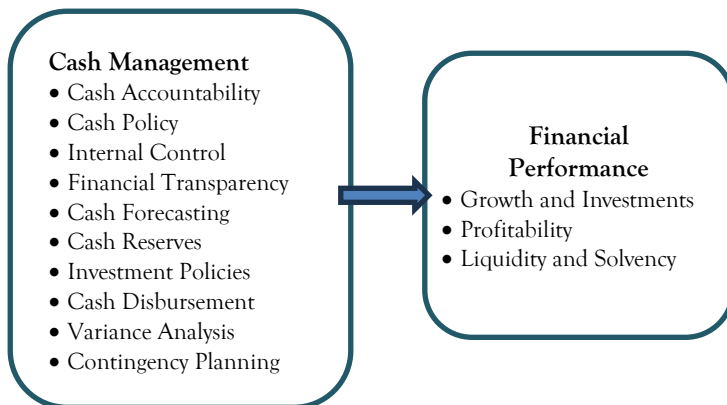


Figure 1: Conceptual framework

Conceptual framework above demonstrates the various independent variables derived from the literature reviewed mapped against financial performance.

3. Discussion and Conclusions

The empirical review focuses on the impact of cash flow on financial management in small and medium enterprises (SMEs). Cash flow management is of utmost importance in the world of SMEs. This management approach involves meticulous oversight by owners and managers to track and control the money coming in and going out of the business. It encompasses various strategies and decision-making processes to optimize financial operations and ensure sufficient liquidity for immediate obligations and long-term planning.

Effective cash flow management is crucial for the financial stability and sustainability of SMEs. It involves monitoring incoming cash from sales, investments, and external financing, as well as tracking outgoing cash for expenses, loan repayments, and other commitments. By effectively managing cash flow, SMEs can strike a balance between inflows and outflows, reducing the risk of liquidity crises and enabling them to seize growth opportunities. This empowers SMEs to make informed decisions about investments, expansion plans, and debt management, which are crucial for overall financial success.

In the world of small and medium-sized enterprises (SMEs), cash flow management plays a crucial role in financial stability and success. SME owners and managers actively oversee the movement of funds within their businesses, employing various strategies and decision-making processes beyond simple observation. Their aim is not only to monitor cash flow but also to maintain precise control over it. Through these ongoing efforts, SMEs optimize their financial operations, ensuring they have the necessary resources to meet immediate obligations and strategically plan for long-term financial well-being. Cash flow management is crucial for small and medium-sized enterprises (SMEs) to maintain financial stability. It involves carefully tracking incoming revenue from sources like sales, investments, and financing, as well as monitoring outgoing expenses like daily costs, loan payments, and financial obligations. Effective cash flow management helps SMEs balance these financial streams to reduce the risk of sudden liquidity problems. It also enables them to make informed decisions about investments, expansions, and debt management, contributing to their overall financial success.

In the world of SMEs, managing demand is essential for business growth. Owners and managers must actively assess and respond to changing consumer trends by employing various strategies and decision-making processes. The goal is not just to observe demand, but to actively control and optimize it. This includes monitoring consumer preferences, seasonal variations, and market dynamics, while also considering supply chain and production capacity to align with demand. By striking a balance between supply and demand, SMEs can mitigate the risks of overstocking or understocking products. This proactive approach empowers SMEs to make informed decisions about inventory management, marketing strategies, and product and service development, ultimately leading to business prosperity.

The literature on the impact of cash flow management on the financial performance of small and medium enterprises (SMEs) in Kenya is crucial for understanding the region's economic dynamics. However, a thorough evaluation of the existing literature reveals both strengths and weaknesses that need careful consideration for the progress of this study.

The current literature provides a general overview of cash flow management in SMEs, but it could benefit from a closer examination of the specific local practices and financial regulations unique to Kenya. By emphasizing the adaptation of global best practices to the challenges faced by SMEs in the region, the literature could offer more practical insights and recommendations tailored to the local context. Additionally, a deeper exploration of socioeconomic factors that influence cash flow management, such as local economic trends, access to financial resources, and government policies, would provide a better understanding of the complex relationship between cash flow management and the broader socioeconomic landscape.

While the existing literature provides valuable insights into the connection between cash flow management and financial performance, it would benefit from a more comprehensive analysis of the methodologies used in previous studies. A thorough examination of the strengths and limitations of various research methodologies would help design a robust methodology for the current study, ensuring the reliability and validity of the research findings. Furthermore, the existing literature may not adequately address actionable policy recommendations that can support the improvement of cash flow management practices for SMEs in Kenya. By providing specific policy suggestions tailored to the local business environment, the literature can offer valuable guidance for policymakers and stakeholders in formulating effective strategies to enhance cash flow management and promote the financial growth of SMEs in the region. A more focused exploration of these aspects would significantly contribute to the advancement of knowledge in this field and provide practical guidance for SMEs in Kenya.

In conclusion, the empirical review underscores the critical role of cash flow management in the financial management of small and medium enterprises (SMEs). Effective cash flow management is imperative for the financial stability and sustainability of SMEs, requiring meticulous oversight and strategic decision-making by owners and managers. By actively monitoring and

controlling incoming and outgoing cash, SMEs can optimize their financial operations, ensure liquidity for immediate needs, and plan for long-term growth and success. Managing demand is also essential for SME growth, as owners and managers must respond to changing consumer trends while balancing supply and demand to avoid overstocking or understocking products. This proactive approach empowers SMEs to make informed decisions about inventory management, marketing strategies, and product development, ultimately contributing to business prosperity.

While existing literature provides valuable insights into the impact of cash flow management on SME financial performance, there are opportunities for further research. Future studies could delve into specific local practices and regulations unique to regions like Kenya, offering practical insights and recommendations tailored to the local context. Additionally, a deeper exploration of socioeconomic factors influencing cash flow management would enhance understanding and inform policy recommendations to support SME growth. In summary, effective cash flow management is crucial for SME financial stability and success, and further research tailored to local contexts can provide valuable insights and guidance for SMEs and policymakers alike.

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